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SUBJECT: USEU SCENESETTER FOR UNDERSECRETARY JEFFERY'S
MEETINGS WITH EU OFFICIALS ON 12 FEBRUA

11. (SBU) Welcome to Brussels. Your visit comes at an opportune time, as the EU is struggling to develop a common energy policy, internally and externally. Recent Commission proposals on internal market liberalization and climate change measures have met with considerable skepticism from member states intent on protecting their large energy firms and their prerogatives over the energy mix. The energy policy debate is raging among the Community institutions, industry and public. A deep uneasiness about Europe's dependence on Russia as an energy supplier adds to this ferment, and the Commission and the Council are working together to develop a more coherent external energy strategy for the EU.

12. (SBU) The Europeans view energy security in broad terms -- to include alternative sources and supply of gas, development of additional renewable resources, research into clean coal, and the deployment of nuclear power plants in selected EU member states. And overlaying the energy security debate here is the imperative that European leaders see to combat climate change. It is thus almost impossible to have energy-related discussions here in Brussels without addressing each of these parts of energy security: internal EU market liberalization, measures to address climate change, and external energy policy.

13. (SBU) Your schedule here covers players in the EU institutions involved in developing a common EU energy policy.

-- Energy Commissioner Piebalgs has the lead role in the Commission on both the internal energy liberalization and the energy/climate package; his is obviously also the key Commission voice on external energy policy. With him, you can note the connection between an open EU energy market and demand for Caspian and Central Asian gas; strengthen his support for Nabucco and TGI; underline the importance of appropriate investment policies, and highlight U.S.-EU collaboration on energy technologies that address climate change.

-- Competition Commissioner Kroes also plays a critical role on energy policy as competition policy is the one area in which the Commission has autonomous power. You should query why existing policy instruments cannot be brought to bear today to open the market and address the problem of dominant foreign suppliers such as Gazprom. The main issue is the "unbundling" of French and German vertically integrated gas

and electric companies.

-- Internal Market Commissioner McCreevy you of course know; although you will want to use this meeting to discuss broader economic and finance issues, he can also provide you important insights into the dynamics of EU policy formation on energy security.

-- Common Foreign and Security Policy High Representative Solana was charged to work with the Commission to fashion the EU's external energy policy, and is well-placed to provide insights into the dynamics among the member states on this issue.

14. (U) We have also arranged for you to have a working lunch with the EU reps of some of the key companies involved in Nabucco and energy development in the former Soviet Union, including the Caspian and Central Asia regions: British Petroleum, OMV, RWE and others.

Proposals

15. (U) The energy sector has been something of an anomaly in the European Community, as the member states have jealously guarded their prerogatives over national monopoly providers and the energy mix. Russia's January 2006 disruption of Russian gas to Ukraine and its knock-on effects on Europe changed all this as the new EU members in Central Europe highlighted the Community's vulnerability to a dominant Russian supplier. European Commission President Barroso and High Representative Solana saw their opportunity to bring energy fully into the Community's ambit, and, as a result of their efforts, the European Union is now moving ahead with

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major initiatives on energy market liberalization, external energy security, and renewable energy. In September 2007, the European Commission presented the "Third Energy Package" intended to increase competition and investment in the internal market for gas and electricity. In January 2008, as part of its Climate and Energy Package, the Commission submitted proposals to increase the share of renewables in the energy mix, promote energy efficiency, and create cleaner-burning fossil fuels. The Commission is also promoting a number of pipeline projects to help meet expected increases in European gas demand.

INTERNAL ENERGY MARKETS

16. (U) New energy sector liberalization proposals under consideration in the EU could have an important role in facilitating distribution of gas from the east, whether through Nabucco or any other pipeline system. The two draft directives and three draft regulations the Commission proposed in September 2007 are designed to ensure greater competition and third party access by effectively separating the supply/production of electricity and gas from transmission networks. Under the proposals, vertically integrated suppliers must either sell off their transmission networks or arrange for their transmission operations to be done by a completely independent subsidiary. In order to ensure that this effective "unbundling" applies as well to non-EU suppliers, the proposals prohibit any company owned by third country nationals from controlling gas pipelines and high voltage lines in the EU, although this prohibition can be waived if the home country of the firm has a bilateral or multilateral agreement with the European Community.

17. (U) The liberalization proposals have met with strong opposition from the member states, led by France and Germany.

This Franco-German coalition appears strong enough to block Commission plans for full ownership unbundling. On the other hand, the coalition's recently proposed third option for "Effective and Efficient Unbundling" does not go far enough to address Commission concerns over lack of competition and investment in the transmission networks. As such, we expect an extended debate in the Council and Parliament over this issue.

¶8. (SBU) We obviously support the EU's move toward energy liberalization because it will stimulate economic growth and contribute to creating the demand needed to support Nabucco and the Turkey-Greece-Italy interconnector. We also share the EU's concern about Gazprom taking advantage of unbundling to expand its position in Europe. The "anti-Gazprom" clause, however, creates a far more restrictive approach to investment in the energy transmission sector than is necessary to achieve the EU's objectives. This is the first time the Commission has proposed such a strict limitation on foreign investment (outside the aviation sector). And ironically the provision might affect countries like the U.S. more than Russia, as the United States has no energy-related agreements with the European Community whereas Russia can arguably point to its signature of the Energy Charter Treaty (ECT) and the EU-Russia Partnership and Cooperation agreement as reasons to waive the prohibition. (Note: Russia has not yet ratified the ECT.) While the clause may not survive in the final directive, you should offer to have our experts work informally with the Commission to find language that achieves our shared strategic ends without unduly restricting the EU's generally open capital markets.

¶9. (SBU) Competition Commissioner Neelie Kroes, with whom you will be meeting, is outspoken about the need for competition in the energy sector, and has pursued fines against a number of EU energy firms for competition violations. Your meeting with Kroes will be a good opportunity to stress our support for market liberalization while at the same time reinforcing our desire for a careful approach that does not unfairly penalize potential investors. You will also have the opportunity to raise our concerns over the third-country restrictions with Internal market Commissioner McCreevy, who is partially responsible for EU laws governing cross-border investment. He and Finance Commissioner Almunia were reportedly the only two

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Commissioners to express concern about the treatment of companies from third countries when the energy package was debated in the college of Commissioners. Although he did not succeed in effecting changes to the text, he will be an influential voice in the debate on the energy package this year. Your meeting provides an opportunity to underscore our strong commitment to avoiding restrictions on foreign investment in the European Union.

EXTERNAL ENERGY POLICY

¶10. (U) About one-quarter of European energy consumption is based on natural gas. Recent predictions suggest that gas demand in the EU will more than double by 2030, while Europe's own production is declining; meeting the new demand will require significant increases in gas-import capacity. The International Energy Agency estimates that European demand could increase by about 200 billion cubic meters, or 7 trillion cubic feet, over the next two decades from 500 billion cubic meters now. To meet these needs the EU will have to develop a number of new transport pipelines.

¶11. (U) To date, the Commission has taken an open approach to new gas infrastructure projects. While publicly supporting Nabucco and TGI they have also supported the Russian Nord Stream and South Stream projects, even though South Stream, which would transport about 30 billion cubic

meters of gas a year from Russia and Central Asia via a sub-Black Sea route that bypasses Turkey, is a direct competitor to the Nabucco project.

¶12. (U) The Commission and Council have proposed a more robust role for the European Union in developing an external energy policy. Javier Solana, whom you will see, just last week delivered a speech in which he argued for a more effective EU coordination on external energy issues. Commissioner Piebalgs supports this as well. The revision of the European treaties that is due to come into effect in 2009 gives the EU additional say over crafting and implementing a common external energy policy. But the EU does not speak with one voice on external energy issues, with Central European member states closest to Russia most concerned about it - and about continued German courting of Moscow. This was displayed over the past couple of weeks as Gazprom made further inroads into the gas distribution and supply in member states.

¶13. (U) One specific concern we have heard and that would be worthwhile raising with Commissioner Piebalgs and Solana is that the EU appears to be less supportive of the Turkey-Greece interconnector. We should emphasize to EU officials that TGI is key to developing another gas corridor of gas out of the Caspian region. We will also have an opportunity to discuss this in more detail with Piebalgs when we have our Energy Security Review discussions in Washington in early March.

ENERGY AND CLIMATE CHANGE

¶14. (U) While its external powers are still relatively limited, the Commission has power under environmental and internal market rules to promote broad measures on climate, energy security, and competitiveness. Commissioner Piebalgs and others will likely raise these issues with you because the Commission sees energy security as part of a broad package of measures including renewables, clean coal, nuclear power, and emissions trading, in addition to new sources of gas supply.

¶15. (U) On January 23, the European Commission released a new energy and climate change legislative package to implement the March 2007 mandate from EU leaders to achieve reductions of 20 percent in EU carbon emissions, increase renewable energy to 20 percent of the EU total, and reach 10 percent biofuels use - all by 2020. The package includes proposals to revise the EU Emissions Trading Scheme (EU ETS) post-2012 and to implement new EU targets on renewable energies through burden sharing among EU member states. The renewables legislation includes a separate mandate for

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biofuels and, controversially, lays out a scheme for certifying the "sustainability" of biofuels. This provision, ostensibly directed to prevent forests and wetlands from being affected by the "rush" to biofuels, could create a massive bureaucratic swamp and have a particularly deleterious impact on developing countries. The Commission also presented a draft legal framework on carbon capture and storage (CCS), designed to permit the geological storage of carbon dioxide. The Commission also has presented recently several initiatives designed to promote the development of energy and climate technologies, including hydrogen fuel cells and cleaner commercial aircraft, which offer the opportunity for third country participation.

¶16. (U) Now that Commission President Barroso has presented the package of initiatives to the European Parliament, it will need to pass both the EU Council and Parliament to enter into force, not expected before the end of the year. As the EU attempts to grapple with the treatment of energy intensive industries under the new rules, Barroso has indicated that

certain industries could be eligible for special provisions. In particular, several sectors may continue to get their emissions allowances for free under the Emissions Trading System, if the Commission determines that significant carbon "leakage" could occur (for example, a steel plant moving to a country without binding CO2 emissions requirements.) Barroso indicated in a speech this week that international sectoral agreements could help, but that the Commission would be prepared to act if no sectoral or overall international climate agreement is reached.

¶17. (SBU) If time permits, it would be worthwhile to discuss these energy and climate issues with Piebalgs. We cooperate actively with the EU on energy R&D, biofuels, carbon capture and storage, energy efficiency and other such issues, and indeed will have a series of meetings related to them the week after your visit and on the margins of WIREC, which Piebalgs will attend. Ideally, we would like him to be a more forceful advocate of a technology-driven approach to climate change in the Commission's internal deliberations about MEM and the UNFCCC. And it would be a bonus if he could underline the extent of our collaboration to help us convince the European public that we take climate change seriously.

¶18. (SBU) To sum up, you are coming to Brussels as key energy and climate-related proposals have been tabled and are being debated widely. The European Commission and Solana are frustrated by the lack of a common EU energy policy and have tried to push the EU to take a more central role on energy. But with member states still jealously guarding their prerogatives, it has been difficult for Brussels to develop a coherent EU-wide approach to energy. You will have the chance to lay down our markers and promote further collaboration with the EU. For, though its energy policy is nascent, Brussels does have powers and is pressing for more. As such, we have the chance to deepen our relationship, particularly on our strategic energy concerns.

Murray

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